BENEFITS INSIDER
A Member Exclusive Publication

Volume 26, March 2007

WEB's ***Benefits Insider*** is a member exclusive publication providing the latest developments from the Nation's Capital on matters of interest to benefits professionals. The content of this newsletter is being provided as a result of a partnership with the American Benefits Council, a premier benefits advocacy organization, which provides much of its core content.

Articles in this Edition

RECENT LEGISLATIVE ACTIVITY

Senate Committee Hears Testimony on Aging Workforce

The Senate Special Aging Committee, chaired by Senator Herb Kohl (D-WI), held a February 28 hearing entitled "The Aging Workforce: What Does it Mean for Businesses and the Economy?" The committee collected testimony from government and academic witnesses on the special challenges of an older workforce.

At the hearing, several prominent benefits organizations urged legislators to focus on the role that flexible retirement programs can play in meeting the needs of both workers and employers, as well as in bolstering the economy and relieving burdens on government programs. They have also created a Phased Retirement Initiative to seek changes in law and policies to remove the obstacles to flexible retirement programs.

In response to information provided during the hearing, Kohl is expected to introduce legislation later this year that would address the needs of older workers. In 2005, Kohl introduced The Older Worker Opportunity Act, a bill designed to encourage use of phased retirement programs by employers. Among other provisions, this legislation provided a tax credit to employers that offer flexible or phased work schedules and meet certain requirements. It is expected that this measure would be included in any older workers legislation introduced this year.

House Education and Labor Committee to Examine 401(k) Fees

The House of Representatives Education and Labor Committee has announced it will hold a series of hearings this spring to discuss fee arrangements in 401(k) and other defined contribution retirement plans. Committee Chairman George Miller (D-CA) said the hearings will be based upon his 2005 request to the U.S. Government Accountability Office (GAO) to report on Changes Needed to Provide 401(k) Plan Participants and DOL with Better Information on Fees. These fees have since become the subject of numerous lawsuits against defined contribution plan sponsors. Miller's panel is expected to hear the testimony of fee experts, examining the range of fees charged and disparity in fees paid by plan participants. A number of well-known employee benefits organizations and plan sponsors are already active on this issue and have developed materials for the Department of Labor (DOL) such as an introductory question and answer document and a glossary of related terms intended to be used with a fee and expense reference tool with service- and fee-related data elements.

Executive Compensation is Front and Center Issue on Both Sides of Hill

On Friday, February 16, the House of Representatives approved the Small Business Tax Relief Act of 2007 by a vote of 360 to 45. While this bill features a number of tax provisions designed to assist small businesses that will subsequently be paired with the proposal to increase the minimum wage, it is of significance that it does not include language addressing nonqualified deferred compensation plans. The House-passed version will soon be reconciled with minimum wage legislation the Senate passed on February 1, by a vote of 94 to 3. This bill contains revenue raising measures that target nonqualified deferred compensation plans and expands the group of employees subject to the $1 million dollar cap on the deduction for compensation. Because of this difference

between the two pieces of approved legislation, several House committees have begun holding hearings to review the Senate bill and the topic of executive compensation in general.

House of Representatives Financial Services Committee Chairman Barney Frank (D-MA) scheduled a March 8 hearing in his committee on executive compensation. The hearing focused on proposals to strengthen the role of shareholders in setting executive compensation. Frank introduced legislation in 2005 to strengthen shareholder authority over executive compensation (The Protection Against Executive Compensation Abuse Act, H.R. 4291) and is expected to do so again this year. Frank's hearing was expected to generate additional press coverage on executive compensation "abuses" and focus additional attention on the provision in the Senate-approved minimum wage bill. Frank has generally taken the position that he does not favor provisions such as the one in the Senate bill that limit nonqualified deferred compensation but would rather see stepped up oversight of such compensation by corporate boards and shareholders.

House Ways and Means Chairman Charles Rangel (D-NY) also scheduled a similar hearing on the Senate-passed bill in March. Testimony at such a hearing gave this panel a more in-depth understanding of the impact that the Senate language could have on nondeferred qualified plan participants, should it be included during the conference to reconcile the two bills. It is expected that Rangel and other members of the Ways and Means Committee could be members of this conference committee, since this panel has jurisdiction over tax-related legislation.

House Education and Labor Committee Approves Genetic Nondiscrimination Bill

A bill prohibiting discrimination in health insurance and employment practices on the basis of genetic information was approved by the House of Representatives Education and Labor Committee on February 14, 2007. The Genetic Information Non-discrimination Act of 2007 (H.R. 493) amends ERISA and the Public Health Service Act to prohibit employer-sponsored group health plans and health insurers providing group and individual health insurance from restricting enrollment or adjusting premiums based on genetic information. Further, it prohibits such entities from requiring or requesting genetic testing. Under a separate title related to employment practices, employers would be prohibited from using genetic information to discriminate against an individual in hiring or other employment opportunities.

The bill is expected to be considered by the two other House committees with jurisdiction – the Ways and Means Committee and the Energy and Commerce Committee – before it is considered by the full House. A companion bill (S. 358) was approved by the Senate Health, Education, Labor and Pensions Committee on January 31, 2007. Similar legislation passed the full Senate by unanimous vote in the 108th and 109th Congresses, but failed to move in the House under Republican leadership. Passage of a genetic nondiscrimination bill is anticipated during this congressional session, given the new Democratic majority.

The measure is largely targeted at potential discrimination since little evidence exists of actual such discrimination. Proponents believe that legislative protections will ensure that individuals will not forego genetic testing if they fear their genetic information could

be used to deny health care coverage or employment. Without careful drafting and consideration of all issues, however, there is potential for unintended consequences in this type of legislation. These include interference with legitimate health plan operations such as preventing a plan from requesting or requiring genetic testing or information for the purpose of making a medical necessity determination. Interpretation of the bill to expand remedies beyond those intended for violations of the legislation's health insurance discrimination prohibitions is also a significant concern.

Senate HELP Committee Passes Mental Health Parity Bill

The Senate Health, Education, Labor and Pensions (HELP) Committee approved the Mental Health Parity Act of 2007 (S. 588) on February 14 by a vote of 18-3. Voting against the measure were Senators Tom Coburn (R-OK), Richard Burr (R-NC) and Wayne Allard (R-CO).

Originally, this measure was introduced by Senate HELP Committee Chairman Edward Kennedy (D-MA) along with two Republican cosponsors, Senators Peter Domenici (R-NM) and Michael Enzi (R-WY). It would require employer-sponsored group health plans covering 50 or more employees to have "no more restrictive" provisions for financial requirements such as deductibles and co-insurance amounts or limits on the duration of coverage than apply to "substantially all" medical and surgical benefits covered by the plan.

The legislation's language also was negotiated with groups representing employers, health plans, mental health care providers and patient advocates. It is considered a more moderate version of previous attempts to legislate mental health parity because it includes several important protections for plan sponsors and health plans including maintaining the ability of plans to apply medical management practices on mental health services and permitting such benefits to be offered solely by in-network health care providers. In addition, the legislation would not mandate that plans cover any specific mental health benefits. Finally, the bill includes an important provision that would preempt states from imposing any parity requirements that "differ from" those in the legislation, a provision intended to help ensure uniformity between the federal requirements and those established by the states.

Under current federal mental health parity law, which has been in effect since 1996, any annual or lifetime dollar limits that a plan applies to mental health benefits may be no less than those applied to coverage for medical and surgical benefits. The new parity legislation would apply a similar concept to plan deductibles, co-insurance, and co-payment amounts or other similar "financial requirements" on covered services. In addition, the legislation would require that any plan "treatment limitations," such as limits on the number of covered days or visits for mental health care services, be no more restrictive than those applied by the plan to comparable medical and surgical services.

Kennedy has indicated he hopes to bring to the bill to the Senate floor by "late winter" and predicted that in the meantime the House of Representatives is likely to act on a separate parity measure sponsored by Representatives Patrick Kennedy (D-RI) and Jim Ramstad (R-MN). The House measure is expected to be introduced shortly and is likely to be much more restrictive than the Senate legislation, possibly also including a broad

mandate on the mental health and substance abuse benefits that employer-sponsored plans must cover.

Baucus Outlines Health Care Principles, Senate Finance Committee Health Agenda
In a speech before the National Health Policy Conference on February 13, Senate Finance Committee Chairman Max Baucus announced that the committee will start an "extensive and thoughtful dialogue" within Congress on health care reform. His speech set forth five guiding principles for wide-ranging health care reform and outlined some of the measures that will be considered by the Finance Committee in the coming months.

His five principles are:

1. **Universal coverage.** "Every American should have a right to affordable health coverage," Baucus said. "Individuals should have the responsibility to get that coverage. And the society should help those who do not have the means to buy insurance on their own."

2. **Sharing the burden.** Baucus suggests creating pooling arrangements, which would bring together large numbers of small purchasers (both individuals and small businesses) to take advantage of group rates for coverage. "Pooling arrangements must be a partnership between public and private sectors," he said.

3. **Controlling costs.** While Baucus supports the notion of reigning in Medicare and Medicaid, he noted that "the Bush Administration's fixation with consumer-driven care only serves to polarize the dialogue." He recommends funding comparative effectiveness research (to determine the effectiveness of treatments), rewarding of high quality care and investing in health information technology. "I will work to get the Senate to pass meaningful health IT legislation again this year. And I will work to get it signed into law," he said.

4. **Prevention.** "We need to encourage primary prevention of disease, when possible. And when primary prevention is not possible, we need to encourage early detection and modification of risk factors," Baucus said. He specifically referenced adult and childhood obesity as a target for prevention efforts.

5. **Shared responsibility.** In clarifying who will pay for these initiatives, Baucus stated that employers, individuals and governments will all contribute.

The Senate Finance Committee agenda includes discussion of a number of specific health care proposals. Baucus hopes to expand the State Children's Health Insurance Program (SCHIP) and expects the committee to consider legislation in the late spring. The committee will also examine incentives for small businesses to provide health care coverage, oversight of the Medicare prescription drug program, the Medicare Advantage program and alternatives to the existing prescription drug "noninterference" law (which was already debated earlier this year).

Bush Administration Releases Budget Proposals for 2008 Fiscal Year, Proposes Means Testing for Medicare D Premiums
On February 5, President Bush unveiled his federal budget proposal for the 2008 fiscal year, which begins October 1, 2007. In the accompanying statement, the President set the goal of a balanced budget by 2012. Excerpts of the individual budgets for the DOL, the

Department of Health and Human Services (HHS) and the Social Security Administration (SSA) are available as well as a Bush Administration analysis of the budget reform proposals and the Treasury Department "Blue Book" explanation of the tax provisions.

Of primary note, the President's budget proposed to increase the Medicare Part B and Part D premiums for higher-income beneficiaries. The income-related premium proposals are part of a broad package of measures intended to reduce Medicare's annual growth rate and strengthen the financial security of the program. As required by the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, premiums for Medicare Part B (which covers a wide range of out-patient services) are means-tested, subject to indexing. The standard monthly Part B premium for 2007 is $93.50. Beneficiaries with incomes above $80,000 (single) or over $160,000 (married couple) will pay from $105.80 to $161.40. Income-related Medicare Part B became effective on January 1, 2007.

The 2008 budget proposes to eliminate current indexing of income for Part B premiums. Elimination of indexing would increase the number of beneficiaries who would pay higher premiums in future years. The budget also proposes extending means testing to Part D premiums by reducing Part D premium subsidies based on the same income thresholds that apply to reduced Part B premiums subsidies. The President's budget also proposes that the new means-tested Part D premiums would not be indexed. Budget documents estimate savings for decreased federal subsidies for higher-income Part D beneficiaries of $357 million in 2008 and $3.2 billion over five years.

Also in the area of health care, recommendations (contained primarily within the HHS proposal) include:

- Replacing the exclusion for employer-sponsored coverage with a standard deduction for those with at least catastrophic health insurance;
- Expansion of the current quality transparency initiative, including provisions for increased information sharing and use of health information technology;
- Changes to Health Savings Accounts (HSAs) to make them more flexible and accessible;
- Increasing the cost-sharing by Medicare beneficiaries, refocusing the SCHIP on the lowest income families; and
- Instituting an "affordable choices" program that would provide grants to individual states to reform the healthcare marketplace.

Proposals regarding retirement savings (contained primarily within the Treasury Department, DOL and SSA proposals) include:

- Increasing the variable rate premium to the Pension Benefit Guaranty Corporation (PBGC) for underfunded plans – the administration will propose legislation to authorize the PBGC (rather than Congress) to set its own variable premium rate (as has been attempted in previous years) and extend the variable rate premium to plans' non-vested as well as its vested liabilities;

- A renewed call for an overhaul of the Social Security system to include personal accounts and changes to the indexing for inflation depending on an individual's income level;

- A slightly revised version of the president's suggested individual accounts (Lifetime Savings Accounts (LSAs), Retirement Savings Accounts (RSAs) and Employer Retirement Savings Accounts (ERSAs)) would be subject to a $2,000 annual limit but the proposal would create a new small employer ERSA); and

- Extending to December 31, 2008, the cut-off time for individuals called to active duty and eligible for penalty-free "qualified reservist distributions."

The initial congressional response to the President's budget, overall, has been cool.

RECENT REGULATORY ACTIVITY

Release and Analysis of IRS Guidance on Rollovers to HSAs

On February 15, the Internal Revenue Service (IRS) released Notice 2007-22, providing guidance on rollovers of funds from health Flexible Spending Arrangements (health FSAs) and Health Reimbursement Arrangements (HRAs) to HSAs. This guidance addresses changes in the tax code resulting from passage of the Tax Relief and Health Care Act of 2006. The relevant provision of the new law is the allowance of a one-time, tax-free transfer of amounts in FSAs or HRAs for the purpose of funding an HSA. FSA participants with a 2½-month grace period would also be allowed to contribute to an HSA during that grace period, subject to certain conditions.

The guidance sets forth the rules (and gives practical examples) for the one-time rollover and provides special transition relief for transfers completed before March 15, 2007. Generally, under the new rules, all of the following conditions must be satisfied in order to receive the favorable tax treatment:

By plan year end:

- The plan must be amended,

- The employee must elect the rollover,

- The year-end balance must be frozen, and

- The funds must be transferred by the employer within two and a half months after the end of the plan year and result in a zero balance in the health FSA or HRA.

Under special transition relief provided in this notice for amounts remaining at the end of 2006, however:

- There is no requirement to freeze the year-end balance in the health FSA or HRA, and

- The amendment, election, and transfer must be completed by March 15, 2007.

The IRS expects to issue additional guidance on this topic in the future.

Missing Non-Spouse Beneficiary Rollovers Required for Terminating Plans
On February 15, the DOL published an interim final rule amending a regulatory safe harbor to require that a deceased participant's benefit be directly rolled over to an inherited individual retirement plan established to receive the distribution on behalf of a missing, designated non-spouse beneficiary. The amendment eliminates the prior safe harbor requirement that a distribution on behalf of a missing non-spouse beneficiary be made only to an account other than an individual retirement plan and reflects the PPA provision allowing (for the first time) a rollover distribution on behalf of a non-spouse beneficiary.

The interim final rule amends two regulations that facilitate the termination of defined contribution plans, including abandoned plans, and the distribution of benefits from the plans. The first regulation provides fiduciaries of terminated plans and qualified termination administrators (QTAs) of abandoned plans with a fiduciary safe harbor for making distributions on behalf of participants or beneficiaries who fail to make an election regarding benefit distribution, commonly referred to as missing participants or beneficiaries. The second regulation establishes a procedure for financial institutions holding the assets of abandoned plans to terminate the plan and distribute benefits with limited liability. Conforming changes were made to notices contained in appendices to the regulations and a related prohibited transaction exemption.

The interim final rule applies to distributions made on or after March 16, 2007.

IRS Clarifies Non-Spouse Rollover Distributions
In the February 13 Employee Plans Newsletter, the IRS clarified that a beneficiary of a deceased participant can take payments over the beneficiary's lifetime after a rollover into an IRA even if the distributing qualified plan did not permit lifetime payments, provided the rollover occurs no later than the year following the year of the death of the participant.

The Pension Protection Act (PPA) contained a provision allowing non-spouse beneficiaries to roll over "inherited" amounts into an IRA. Recent guidance issued by the IRS had caused confusion about whether the lifetime payments option was available to a beneficiary when the distributing plan does not permit it and the participant dies before he or she is required to start receiving minimum distributions (caused by the interaction of the special rule in Q&A 17 with the general rule in Q&A 19 of IRS Notice 2007-7). The newsletter clarifies that even if a plan offers only a five-year payout option, non-spouse beneficiaries who roll over amounts into an IRA before the end of the year following the year of the participant's death may elect to receive distributions from the IRA either under the five-year payout option or, alternatively, over their life expectancy. The newsletter also clarifies that plans are not required to offer rollovers to non-spouse beneficiaries.

DOL, EBSA Issue Rule on Cross-Trading Statutory Exemption

The DOL's Employee Benefits Security Administration (EBSA) released an interim final rule on February 12 addressing the new statutory exemption on cross-trading under the PPA. Cross-trading refers to a transaction in which an investment manager uses its authority to sell a security on behalf of one client and to buy that same security on behalf of another client. The PPA's statutory exemption allows investment managers of ERISA plans to execute cross-trades if certain conditions are met, including the adoption of written cross-trading policies and procedures. The interim rule, effective April 13, 2007, establishes the requirements for the policies and procedures investment managers must adopt to engage in cross-trades. Written comments on the rule must be submitted to EBSA by April 13.

Treasury/IRS Release Final Regulations on Mortality Assumptions

The Treasury and IRS issued final regulations on the mortality assumptions that a defined benefit plan must use in determining current liability for minimum funding purposes. The release largely adopts unchanged the proposed version of the regulations issued in December 2005. The final regulations were effective February 2, and will apply to plan years beginning on or after January 1, 2007. Highlights of the final regulations include:

- Adoption of RP 2000 Mortality Table – Prior to the adoption of these final regulations, a defined benefit plan's liabilities were calculated using a table that was based on the 1983 Group Annuity Mortality Table (GAM 1983). The proposed and final version of these regulations contains a mortality table that is based on the RP-2000 Mortality Table.
- Use of Blended Mortality Rates in 2007 – The proposed regulations generally required a plan to measure liability using two separate rates for annuitant and nonannuitant periods. The annuitant rates apply for the periods a participant will receive benefits and the nonannuitant rates apply for the periods prior to when a participant begins receiving benefits. The proposed version of these regulations allowed small plans with less than 500 participants (including active and inactive participants) to use a blended rate that combined the annuitant and nonannuitant rates for determining liability. Under the final regulations, any plan may use a blended rate for determining liability in 2007.
- Relationship to the PPA – Regulations under the PPA-created funding requirements, including its mortality changes, is expected in 2007. For this reason, final regulations issued generally only apply to 2007; however, the expectation is that RP-2000 will be used in determining liability under the new PPA rules as well.

Treasury/IRS Consider Guidance on Benefits That Can Be Provided in DB Plans

The Treasury and the IRS issued Notice 2007-14, which indicates the regulatory agencies are considering providing clarification of the types of benefits that can be provided in a qualified defined benefit plan.

Treasury and the IRS indicated they are concerned that some defined benefit plans may include nontraditional benefits not subject to the protections of Code Section 411 (which, among other things, provide that plans cannot be amended to reduce previously accrued

benefits) and the qualification rules of Code Section 401(a). Specific examples of areas of concern provided include (1) benefits payable only upon the involuntary termination of an employee or in other limited circumstances unrelated to retirement, and (2) benefits that could exceed the amount of the accrued benefit payable under the plan. The focus of the concerns appears to be on benefits contingent on non-predictable future events.

Treasury and the IRS indicate this guidance is appropriate in light of the regulations under Code Section 411(d)(6) issued in 2005 because definitions in the regulations of ancillary benefit, retirement-type benefit, and retirement-type subsidy depend, in part, on whether a benefit is permitted to be provided in a qualified plan. The notice provide examples of guidance that MAY be provided in the regulations including that benefits permitted in a defined benefit plan would be limited to retirement-type benefits, retirement-type subsidies, and ancillary benefits specifically identified in Treas. Reg. Section 1.411(d)-3(g)(2). Possible guidance on plant shutdown benefits and similar ancillary benefits as well as contingent accruals and early retirement benefits were also provided.

Treasury and the IRS requested that comments on the issues they raised be submitted by May 13. They anticipate any guidance would be prospective only and specifically requested comments regarding appropriate transition rules.